COMMONWEALTH OF KENTUCKY

BEFORE THE

PUBLIC SERVICE COMMISSION OF KENTUCKY

IN THE MATTER OF

AN EXAMINATION OF THE APPLICATION	)	
OF THE FUEL ADJUSTMENT CLAUSE OF	)	
KENTUCKY POWER COMPANY	)	**CASE NO. 2006-00507**
FROM NOVEMBER 1, 2004 THROUGH	)	
OCTOBER 31, 2006	)	

KENTUCKY POWER COMPANY

RESPONSES TO KIUC FIRST SET OF DATA REQUESTS

February 23, 2007

Kentucky Power Company

REQUEST

Please provide a comprehensive explanation and description of the treatment of fuel expenses in the fuel adjustment clause incurred by he Company as a result of a PJM order requiring the Company and AEP to dispatch a unit out of economic merit order. Also include a description/explanation of the treatment of any payments received by the Company and AEP to compensate the Company and/or AEP for such a required out of merit order dispatch. Include copies of relevant PJM tariff pages that specifically address this issue.

RESPONSE

PJM's basis for unit dispatch is to find the most economic solution to serve the load over PJM's footprint in order to minimize the cost to PJM Load Serving Entities (LSEs) and other market participants. Each day, on a "day-ahead" basis, AEP (on behalf of Kentucky Power Company (KPCo) and its other eastern operating companies with generation) and other generation owners offer their generation into the PJM market. Generators provide the cost to operate the unit, the availability of each unit (outage and maintenance curtailment schedules), operational limits, and unit minimum run and down times. In granting day-ahead awards to generators, PJM utilizes a security constrained, economic dispatch solution for the next three to seven days, based on the availability and the known operating parameters of the generators. Since PJM awards generators on an hourly basis, there can be hourly periods when the day-ahead award to a generator is below its operating cost for that hour. If PJM does not deselect the generator for those hours, it is because doing so did not provide the most economical solution based on certain factors including the minimum down time, transmission reliability concerns, blackstart capability, etc. Although some refer to PJM's award of a unit under these conditions as an "out of merit" dispatch order, that is not accurate. In reality, although the unit may not be economical in a particular hourly period, the unit can be the most economical choice over the multiple day period for which planning decisions must be made while also being available when load is higher.

This method of economic unit dispatch is similar to AEP's dispatch operations prior to its membership in PJM. AEP sought to minimize the overall cost to its native load customers in economically dispatching its fleet. Sometimes that meant leaving a large (base load) generator on-line (at minimum load) over a mild weekend to have it available for a subsequent Monday and Tuesday with a significantly higher load forecast. If AEP chose to "cycle" the larger unit (shutting it down on Friday and bringing it on-line Monday or Tuesday) while bringing smaller, higher cost units on-line in its place, it may have reduced some fuel costs in the short-term, but could have increased overall costs in the long–term because of start-up costs and higher maintenance expenses.

PJM provides generators with operating reserve credits (also known as "make whole" payments) as compensation for instances when they are running per PJM dispatch instructions, but do not receive sufficient revenues from the energy market to cover their costs or for times when they are required to remain on-line for transmission reliability, blackstart capability, etc.

PJM's operating reserve credits to AEP's generation are allocated to KPCo using the Member Load Ratio (MLR) methodology. As a result of KPCo's latest General Adjustment in Electric Rates (Case No. 2005-00341), which was a settled case, the test year amount of KPCo's MLR share of PJM operating reserve credits were applied to base rates. These operating reserve credits include both fuel and variable Operations and Maintenance costs.

Relevant PJM tariff pages that specifically address operating reserve credits can be accessed via the following web site addresses:

http://www.pjm.com/contributions/pjm-manuals/pdf/m28.pdf (PJM Manual 28: Operating Agreement Accounting. See Section 5.)

http://www.pjm.com/documents/downloads/agreements/tariff.pdf (PJM Open Access Transmission Tariff. See Section 3.2.3, p. 858-866.)

WITNESS: Errol K Wagner

Kentucky Power Company

REQUEST

For each of the months November 2004 through October 2006, please provide a list of each such occurrence of PJM order dispatch as described in Q1 above. For each such occurrence, provide the revenues received by the Company and AEP and the cost to the Company associated with the required dispatch (in terms of the incremental fuel expense incurred during the month).

RESPONSE

See response to KIUC 1-1. AEP does not interpret the PJM security constrained economic dispatch to produce "out of merit" dispatch. As noted in the response to KIUC 1-1, PJM solves for the least cost, security constrained economic dispatch solution while maintaining the reliability of the PJM transmission system.

PJM awards operating reserve credits to generators in two ways. First, in the "day-ahead" market, PJM will award operating reserve credits when requesting a unit to come on-line for reliability purposes or requiring a unit to remain on line, but the "day-ahead" energy market does not provide sufficient revenues to the generator to cover its costs. PJM also calculates operating reserve credits in the "real-time" market on an hourly basis for hours when PJM's dispatch instructions cause the generator to run although it cannot cover its costs. However, PJM reviews their "day-ahead" and hourly "real-time" operating credits against each generator's daily revenue (total of "day-ahead" and "real-time") generated by their participation in the PJM market. If a generator's revenues exceeded their costs over a daily period, PJM ignores the fact that the generator lost money in certain hours due to PJM's dispatch orders and awards no operating reserve credits. If the generator lost money for the day by following PJM's dispatch instructions, PJM pays operating reserve credits. PJM computes these hourly charges and credits to generators during "real-time" operations, and then arrives at a net total at the end of the day. However, it is not practicable, based on the information provided by PJM, for AEP to determine the credit received for each "out of merit" dispatch occurrence, whether an "occurrence" is defined on a daily, hourly, or on a five minute dispatch basis.

In addition, it would be burdensome, and extremely time consuming, for AEP to attempt to determine the cost to each generator in terms of incremental fuel expense for each "out of merit" dispatch occurrence. As stated in the response to KIUC 1-1, PJM operates the transmission system and generation fleet on an economic basis for their entire interconnected footprint. PJM does this on a three to seven day outlook in the "day-ahead" market, and on five minute basis in the "real-time." Each PJM real-time dispatch is based on economically and reliably assigning generation resources to serve load, while maintaining reserves and grid stability and reliability. AEP has no means of reconciling each "out of merit" dispatch request for each generator against what the PJM dispatch for that unit (and for all other AEP units) would be in the absence of the "out of merit" dispatch order. In other words, AEP may not be able to determine the incremental change in the operation of the unit that was requested by PJM. AEP does not have access to the security constrained economic dispatch solution, cannot reconstruct the solution, and therefore has no basis against which to calculate the incremental fuel cost of each dispatch.

In any event, KPCo is credited with operating reserve credits equal to its MLR share of the total of such payments received by AEP and not the amount of payments received by AEP with respect to KPCo units.

WITNESS: Errol K Wagner

Kentucky Power Company

REQUEST

Please provide an annotated copy of the Company's fuel adjustment clause filing for one of the months during the period November 2004 through October 2006 (selected by the Company) in which the Company received payment from PJM or incurred additional expenses as a result of an economic merit order dispatch. The requested annotations should demonstrate the treatment of the expenses associated with the out of economic merit order dispatch and the treatment of any payments received by the Company as compensation from PJM.

RESPONSE

As explained in the response to KIUC-1, the premise for this data request, that units are dispatched out of economic order is not well-founded.

The requested annotations can not be made for the reasons described below. A copy of KPCo's June 2006 Monthly Fuel Adjustment filing can be found on the Commission's website below:

http://psc.ky.gov/pscfac/American%20Electric%20Power/2006_AEP.pdf

The Company received $8,858.65 in Operating Reserve Generating revenue payments from PJM during the month of June 2006. As the Company stated in its response to KIUC Item No. 1, these payments include costs other than fuel costs.

The fuel costs associated with these payments are recorded in the FERC Uniform System of Account for Public Utilities and Licensees, Account 151. The Operating Reserve Generating revenues received from PJM through AEP are recorded in the FERC Uniform System of Account for Public Utilities and Licensees, Account 447, which is a revenue account. Under the applicable Commission regulation, 807 KAR 5:056, Kentucky Power can not offset these revenues against fuel costs. Specifically, it provides, that "the cost of fossil fuel shall include no items other than the invoice price of fuel less any cash discounts. The invoice price of fuel includes the cost of the fuel itself and necessary charges for transportation of the fuel from the point of acquisition to the unloading point, as listed in Account 151 of the 'FERC Uniform System of Accounts for Public Utilities and Licensees.'"

Although not reflected in the fuel adjustment clause, KPC ratepayers receive the benefit of Operating Reserve Generating revenues, As Company witness Bradish testified at page 12 lines 9 through 12 of his testimony in KPC's most recent rate case, "Make Whole Payments" are included in the "Net Other Costs or Revenues" which is included as a base rate item in the Company's cost-of-service. These Operating Reserve Generating revenues reduced the Company's cost-of-service the rates are designed to support. The amount of these Operating Reserve Generating revenues included in the test year was $1,971,250. This was calculated by using the actual nine months of historical payments October 2004 through June 2005 ($1,478,437.56) and dividing it by nine to arrive at a monthly average level and taking that result times twelve to arrive at a twelve month average amount of $1,971,250.

WITNESS: Errol K Wagner